IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia and Ex Officio Insurance Commissioner of the State of West Virginia; H. ISAIAH SMITH and ROSS B. THOMAS, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE AND A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

BRIEF OF EDGAR B. SIMS, AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, AND H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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JARRETT PRINTING COMPANY, CHARLESTON, W. VA.

INDEX

Subject Index

Cases Cited

Authorities Relied Upon

Statutes Cited

ACTS OF CONGRESS:

UNITED STATES CODE ANNOTATED:

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FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

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STATEMENT AND OPINIONS BELOW

Fidelity Assurance Association of Wheeling, West Virginia (hereinafter called the "DEBTOR"), and Central Trust Company of Charleston, West Virginia (hereinafter called the "TRUSTEE"), have petitioned this Court for the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit to review a decision of that Court entered on the 16th day of June, 1942 (rehearing denied July 22, 1942), reversing an order of the United States District Court for the Southern District of West Virginia entered Janu-

ary 5, 1942; which order sustained that District Court's jurisdiction to entertain the Debtor's petition for reorganization under Chapter X of the Bankruptcy Act, and overruled certain motions to vacate orders of the District Court with reference to the custody and control of securities deposited by the Debtor, in accordance with State law, with States and officials thereof in each of fifteen States of the United States. The Circuit Court of Appeals ordered the case remanded for the purpose of dismissing the Debtor's petition on the ground that Debtor was an insurance company when its petition was filed on June 6, 1941, and that the said petition was not filed in good faith as defined in Section 146, particularly (3) and (4), of said Chapter X. The opinion of the District Court (Moore, D. J.) is reported in 42 F. Supp. 973 (S. D. W. Va.), and the unanimous opinion of the Circuit Court of Appeals is reported in 129 F. (2d) 442.

JURISDICTION

The order of the Circuit Court of Appeals was entered on June 16, 1942 (R. 387) (rehearing denied July 22, 1942 (R. 397)). The petition for a writ of certiorari was filed on the 20th day of August, 1942. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. 347) and Section 24(c) of the Bankruptcy Act (11 U. S. C. A. 47(c)).

STATUTES INVOLVED

(Set out in full in Appendix A)

Section 4 of the Bankruptcy Act as amended by the Act of June 25, 1910, 36 Stat. 839, 11 U. S. C. A. 22.

Section 141, Chapter X of the Bankruptcy Act (11 U. S. C. A. 541).

Section 144, Chapter X of the Bankruptcy Act (11 U. S. C. A. 544).

Section 146 of the Bankruptcy Act, and parts (3) and (4), (11 U. S. C. A. 546).

Sections 156 and 158(4), Chapter X of the Bankruptcy Act (11 U. S. C. A. 556, 558).

Section 9(a) (b) of the Investment Company Act of 1940 (15 U. S. C. A., Sec. 80a-9(a) (b)).

Code of West Virginia, Chapter 31, Article 1, Section 73[1].

STATEMENT OF THE CASE

Foreword

There are seven respondents in this case (R. 363 for official designation, and 42 F. Supp. 476 for their official representation) who filed joint and several appeals in the Circuit Court of Appeals, six of whom filed controversial answers in the District Court to the Debtor's petition; five of them, for the purposes of brevity, will be referred to hereinafter as the Wisconsin, Iowa, Missouri, Tennessee and Maryland respondents. This brief is being filed jointly in behalf of Edgar B. Sims, Auditor and ex officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers (R. 3), hereinafter referred to jointly as the West Virginia respondents, and separately as Auditor of West Virginia and West Virginia Receivers.

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1 Other statutes involved by reason of questions presented below, but not there determined, are: Code of W. Va. 12-5-2, 6; 33-9-3, 10; 33-2-45; 33-2-12; Art. VI., Sec. 35, Const. of W. Va.; Tenth Amendment to the Const. of the U. S.; Eleventh Amendment to the Const. of the U. S.; Sec. 111 of Ch. X of the Bankruptcy Act (11 U. S. C. A. 511); Sec. 116(1), Ch. X of the Bankruptcy Act (11 U. S. C. A. 516); Sec. 128, Ch. X of the Bankruptcy Act (11 U. S. C. A. 528); Sec. 216(4) of Ch. X of the Bankruptcy Act (11 U. S. C. A. 616); Statutes of the States where Debtor made deposits, set out in the Appendix of each brief discussing such statutes.

Four briefs will be filed in opposition to the petition for writ of certiorari on behalf of the respondents, Wisconsin and Iowa respondents filing a joint brief, Tennessee and Missouri respondents filing jointly, and Maryland filing separately. Counsel representing the respondents have agreed to divide the legal points and arguments thereon among themselves. It will, therefore, be necessary for the Court, if it will, to consider all of the briefs filed in opposition jointly as one composite brief, in order to reach a complete understanding of the points raised in opposition.

Only this brief of the West Virginia respondents will contain the "Statements and Opinions Below," the grounds upon which "Jurisdiction" is invoked by the petition, and a list of the "Statutes Involved," with each of the briefs filed setting out in full those particular statutes with which that brief will concern itself.

Each brief will include in its "Statement of the Case" only so much as is necessary to argue the points of law intended to be raised in that brief; each will contain a statement of the "Issues" with which it will deal; each will contain in its appendix such parts of the typewritten record, sent by the respondents to the Circuit Court of Appeals, but not printed by petitioners here, as are deemed necessary.[2] We hope that this procedure will merit the Court's approval.

(All emphasis in this brief is by counsel, unless otherwise noted.)

Statement

The opinion of the Circuit Court of Appeals contains a complete and accurate summary of the facts upon which the points of law decided in that opinion were based.

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2. "R. ____" will be used to denominate the page of the record as printed for this Court, and "T. ____" will be used to designate the page of the typewritten transcript. Reference to exhibits of the record sent to the Circuit Court of Appeals will be made by "Exh. ____, p. ____"

The opinion of the District Court (R. 3, 4) (42 F. Supp. 973, at 976) correctly sets forth how the case arose, and (R. 16, 17) (p. 981) correctly sets forth the contentions of your respondents which were therein raised.[3] The statement of facts of the District Court (R. 4-17) (42 F. Supp. at 977-981) is substantially correct, but not entirely complete. It is necessary to supplement those facts with those which follow, in order to argue correctly the issues hereinafter discussed in this brief.

In August, 1940, F. H. Pulfer, Sales Manager and Director of Debtor, brought to it one Allen G. Messick (T. 794), a Chicago promotor, who was to furnish or procure $500,000.00 to enable Debtor to continue business (T. 796). Over fifty per cent. of both the preferred and common stock of Debtor was then trusteed in John Marshall, of Washington, D. C. (R. 298, Exh. No. 95), for the purpose of enabling him to deal with Messick. Marshall's father-in-law had been one of the five founders of Debtor, and Marshall had been on its payroll at least since 1929 (T. 2939), and had served the company as its attorney, general counsel, chairman of the board, and in various other ways, for many years. For many years it had paid a part of his office rent, telephone bills, and stenographic expenses (T. 2910-11). Marshall apparently never purchased more than 110 shares of its stock, but by stock dividends came to own 750 shares of common and 275 shares of preferred stock (See Trustee's Partial Section 167 Report, p. 50). His son, John Marshall, Jr., shortly after leaving college, was made a vice-president and director of the Debtor (T. 967-8), and after Messick became chairman of the board, an assistant treasurer.

The Messick deal fell through. No money was furnished and Messick, who purportedly had come to bring money,

3 These same contentions were advanced in the Circuit Court of Appeals, whose decision was based upon only two of them (R. 363).

stayed as chairman of the board at a salary of $1,000.00 a month (T. 872) until Auditor Sims of West Virginia learned of it and prohibited further payment (T. 518-19-88). After April 11, 1941, when Auditor Sims instituted statutory receivership proceedings for the Debtor in West Virginia, with the Debtor's consent, and after the Debtor's directors had unanimously agreed to State Court proceedings in preference to any other proceedings (See Exh. of Minute Book of Board of Directors' Meetings, pp. 173-174), Messick interested an old school friend, James R. Fleming, an attorney of Fort Wayne, Indiana (T. 3601-2), who then undertook to look out for Mr. Marshall's stock interests. (T. 2974-75, 2446, R. 189, 190.)

Six of the eight directors of Debtor met in Pittsburgh, Pennsylvania, on June 3, 1941, in a purported directors meeting (T. 1680-82; R. 13) (42 F. Supp. 980), after Marshall, Messick and Fleming had conferred together (T. 2965, 2971, 2994). These six were Marshall and Marshall's son, both of whose services had been dispensed with by the State Court Receivers (T. 3796), the latter owing, and ill owing, Debtor over $1,000.00 for rent on his home as ell as unpaid checks issued by him to Fidelity, which indebtedness Auditor Sims of West Virginia insisted should be paid (T. 547); Pulfer, who had not only been discharged by the Receivers but who owed the company $8,000.00 which he had drawn as advance salary and had not repaid, and did not think he should, and which Auditor Sims insisted must be repaid (T. 812); Messick, who had been let out by the State Court Receivers and who, on the day of their appointment, requested payment for the back salary which Auditor Sims had prevented him from getting (R. 143); Howard Reed, Vice-President, and A. L. King, who had not been retained by the West Virginia Receivers. Needing a seventh director for a

quorum, they purported to elect Fleming, who was there by invitation, a director for the purpose of the meeting, although he was not, and never became, a stockholders, as required by By-Law No. 6 (R. 187) (T. 378, 1678) (R. 13) (42 F. Supp. 980), and who stated that in the light of future matters he deemed it preferable for him not to become a member of the board and serve thereon, but as an emergency confronted them, he would consent to become a member of the board to make a quorum, but that he would resign at the close of the meeting, and who did purportedly resign immediately after the meeting (R. 14) (42 F. Supp. 980). This meeting then voted to file the instant petition in bankruptcy, under Chapter X, in behalf of the Debtor, and on June 6, 1941, Fleming, together with Messick, did file the instant petition (T. 3601-2, 925) (R. 14) (42 F. Supp. 980).

Immediately after the petition was filed, the District Court, *ex parte*, approved the petition as being filed in good faith and having all the necessary requisites for the Court's jurisdiction under Chapter X (R. 323, 324), and appointed the Central Trust Company, of Charleston, West Virginia, the Trustee (R. 3, 324) (42 F. Supp. 976). On the following morning, June 7, 1941, still *ex parte*, upon petition by the Trustee, the Court appointed Townsend and Townsend, of Charleston, West Virginia, as the attorneys for the Trustee, and on further petition by the newly appointed Trustee, the Court authorized the Trustee to employ Fleming and Messick "for the purpose of assisting your Trustee in marshaling the assets of said Debtor which are now situate in divers states outside the territorial limits of the State of West Virginia, and also for the purpose of assisting Trustee in the development and formulation of a plan or reorganization for the affairs of Debtor in this proceeding, and that your Trustee be also authorized by the Court to employ the above

named to perform any other special services other than that of general counsel for the Trustee * * *."

The respondents thereafter contended that Messick and Fleming had been employed by the Trustee, and although it was shown, and not denied, that they went to the State of Wisconsin, at the request of Townsend and Townsend, the Trustee's attorneys (R. 166), conferred with officials there (R. 153), and conferred with the officials of many of the depository States the next day in Chicago, and stated that they had been retained by the Trustee and authorized to speak for it (R. 150), the District Court during the hearing stated that they were never employed by the Trustee (R. 294) and during the hearing refused to receive any evidence which would tend so to show (R. 163), and later, in its opinion, so held (R. 16) (42 F. Supp. 981).

Immediately after their appointment, State officials, particularly those in West Virginia, challenged the right of Messick and Fleming to be employed by the Trustee (R. 162); Messick's appointment was promptly rescinded and that of Fleming by order of August 1, 1941 (R. 16) (42 F. Supp. 980).

As set out by the District Court (R. 4) (42 F. Supp. 976-77), immediately upon filing the petition, turn-over orders, later modified to "freezing" orders (on Aug. 9, 1941) were issued to all State officials with regard to the deposited funds held by them. Certain of the States thereupon filed controversial answers and made motions to vacate these turn-over and "freezing" orders, Maryland appearing specially for that latter purpose (R. 199). Hearings were had before the District Court on the issues joined, beginning on August 5, 1941, and lasting intermittently until October 10, 1941 (R. 4).

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4 Petition and order June 7, 1941, a part of the record sent to the Circuit Court of Appeals.

Fleming appeared in the District Court as the attorney for the Debtor (42 F. Supp. 976), although never authorized so to do other than by the meeting of the board of directors above set out.

The District Court, after a full hearing on this question, held (R. 21):

> "The purported directors meeting of June 3, 1941, was not a legal meeting and the directors could not at that meeting grant any valid authority to any person to file the petition for reorganization."

Purported Ratification Meetings

September 17th Meeting

On September 17, 1941, the six directors who had purportedly met in Pittsburgh were all summoned, in Debtor's behalf, to testify at the hearings before the Court, at Charleston, West Virginia. (R. 138.) On that day as well a meeting of the board of directors was called, at which Messick, Marshall, Marshall's son, Pulfer and Reed attended, as well as D. A. Burt, A. L. King having in the meantime resigned. An offer of proof was made to the District Court which was rejected, that the president of the corporate Trustee herein attempted to persuade A. L. King to attend that directors meeting. (R. 136, 137). As well as the six directors mentioned, Wheeler Bachmann was present, he having been elected a director at the annual meeting of the Debtor in February, 1941 (Exhibit of Directors' Minutes, p. 172), and who had, upon notification thereof, declined in writing immediately thereafter to serve as such director (Exhibit Board of Directors' Minutes p. 177) (R. 15, 22). Marshall and Messick in their testimony earlier in the hearing had sworn that Bachmann was not a director on June 3, 1941 (T. 886-8-9, 422, 435).

With Bachmann present to complete their quorum, the six directors purportedly elected Marshall's nephew, Philip Paull (R. 15), to the board, and with these seven directors present, Bachmann not participating (Exh. Minutes of Board of Directors, p. 179), they purportedly ratified the authorization of June 3rd in filing the petition on June 6th (42 F. Supp. 983). No permission of the District Court to elect Paull a director was obtained as required by Section 191 of Chapter X.

The minutes of this meeting were immediately brought to Court and introduced in evidence, and after adjournment of Court on that day, Bachmann purportedly resigned from the board (Exh. Board of Directors' Minutes, p. 181).

New Attorneys for Debtor

Shortly thereafter, Fleming quit the trial and never reappeared, and although his name has continued to be used, has never since appeared at any hearing or argument in either the District Court or Circuit Court of Appeals, and no communication or answer to such has ever since that time been received by any counsel for respondents. Taking his place came John V. Ray, of the firm of Payne, Minor and Ray, of Charleston, West Virginia, who are listed in Martindale in both 1941 and 1942, as general counsel of the Central Trust Company, the disinterested Trustee herein, and that general representation has not been denied. Mr. Ray has since represented Debtor, although his right so to do, without corporate authorization, was promptly, and still is, challenged.

After the decision of the Circuit Court of Appeals, Mr. Homer Holt, beginning July 13, 1942, has acted with Mr. Ray as counsel for the Debtor, and he frankly admits that his firm is private counsel for the Central Trust Company,

Trustee herein, and it has advised with him concerning its private liabilities in connection with this estate, and that he was requested to appear for Debtor only by Mr. Marshall.

October 3rd Meeting

The next time testimony was taken before the District Court, Mr. Ray, as attorney for the Debtor, apparently abandoned the legality of this September 17th meeting (T. 2263), and failed to produce Mr. Marshall for cross-examination concerning that meeting, and asked permission of the Court to hold a further meeting of the board of directors and stockholders, and to reelect the old group as new officers and directors.

Section 9(a) of the Investment Company Act of 1940 (15 U. S. C. A., Sec. 80a-9(a)) makes it unlawful for anyone to serve as an officer or director of a company when such person is enjoined from "engaging in or continuing any conduct or practice in connection with * * * the purchase or sale of any security * * *." All of the officers and directors, except Messick, were enjoined in the Detroit suit brought by the Securities and Exchange Commission in 1938, in the consent decree entered therein, from engaging in certain practices in the sale of Debtor's securities. (42 F. Supp. 979; R. 10; Exh. 6, pp. 97-258.) Marshall and others had applied to the Securities and Exchange Commission for permission to serve as directors and exemption from this provision, as provided in Section 9(b) of the Act. It had not been granted (R. 22). Therefore, objection was made that the District Court was without power to give permission, under Section 191 of Chapter X, to these men who had been enjoined, to serve as officers and directors of the company.

It was further objected that permission to hold such meeting should only be granted upon condition that the

equitable owners of the stock be permitted to vote it and not have it voted by Marshall, in whose name it was still trusteed. Since it was undenied that at least under West Virginia law the company had become an insurance company on December 31, 1940, the insurance laws of West Virginia (Ch. 31, Art. 1, Sec. 73) prohibiting a voting trustee for stock in any insurance company, it was argued to the Court that the Court should not give Marshall permission to vote this stock in ratification of his own acts.

The District Court overruled all objections and granted permission to hold stockholders and directors meetings, which were held on October 3, 1941. At the stockholders meeting the tellers reported 9,887 shares present out of a total of 17,235 shares, and Marshall, as trustee, voted 9,570 shares (Exh. of Minute Book of Directors' Meetings, p. 191). Ratification was voted by him of the former directors meetings and of the filing of Debtor's petition, and new directors were elected, among whom was Marshall's nephew, Philip Paull, and his brother-in-law, James Paull. These directors then not only ratified all acts that Marshall had previously done, but ratified a resolution passed at the purported meeting of September 17th, as follows:

> "RESOLVED, further, that John Marshall, Sr., be, and he is hereby authorized, directed and empowered to do such acts and sign such papers as may be necessary to prosecute the pending proceedings, or a new proceeding, for a corporate reorganization under Chapter X of the Federal Bankruptcy Act."

The District Court, in its opinion, held the meetings of September 17th and October 3rd valid corporate meetings, and the ratifications therein voted, ratified and validated that which was done at the meeting of June 3rd,

and therefore that the petition had been properly filed (R. 23) (42 F. Supp. 984).

The District Court, in its opinion (R. 27, 30) (42 F. Supp. 985, 987), however, held that the stockholders of the Debtor had no interest of any kind whatsoever in its assets, which was confirmed by the Circuit Court of Appeals (R. 383). This controversy is being carried on, and this petition is filed on behalf of stockholders *only*, who have had, up to the present time, the Trustee pay all of their costs and expenses, except counsel fees, out of the funds of the contract holders in the possession and under the control of the Trustee, and without any corporate authority on the part of the Debtor, other than that which is set out above, and over the continued objection and protest of a number and groups of contract holders.

Immediately after the Federal proceedings were instituted, not only State officials but numerous contract holders and groups of contract holders contested the bankruptcy proceedings, and have been doing so ever since. During the existence of the State Court proceedings of April 11th to June 6th, in West Virginia, there was only one objection filed on behalf of a single contract holder to those State Court proceedings. That was filed by the same firm of attorneys of which Mr. Holt is a member, and who now represent the Debtor, and the substance of that objection was that there should be a corporate receiver appointed instead of solely individual receivers.

Over numerous objections and exceptions, the attorneys appointed for the Trustee, throughout the hearings of the District Court, engaged in that jurisdictional controversy and undertook to sustain Debtor's petition and the jurisdiction of the District Court which appointed that Trustee and those attorneys. (T. 3620, 3625, 3634, 3642, 3644.)

QUESTIONS PRESENTED

Of th questions, only the following are discussed in this brief:

I. Debtor's petition was not filed in "good faith" as that term is ordinarily used, nor as defined in Section 146(4), Chapter X, and there was never any valid corporate authority authorizing the petition to be filed.

II. The petitioners herein, that is the Trustee and those acting purportedly in behalf of the Debtor, cannot rightfully file a petition for writ of certiorari.

(The following questions were presented below, but not discussed nor decided in the opinion there, and are discussed briefly hereinafter, in an "Addendum" to this brief, as substantiating the correctness of the decision and judgment of the Circuit Court of Appeals):

III. The Eleventh Amendment to the Constitution of the United States prohibited the District Court from taking jurisdiction over the funds deposited with the States and over the State officials having custody and control thereof.

IV. The petition was not filed in the proper venue, under Section 128 of Chapter X, and under Section 111, the Debtor had no property within the District Court's territorial jurisdiction.

V. The orders of the District Court directed against State officials are void under the Tenth Amendment to the Constitution of the United States.

VI. The delivery of securities by the Debtor under the depository laws of the various States constituted contracts in the public authority within the meaning of Chapter X of the Bankruptcy Act, which the District Judge could not permit to be rejected.

SUMMARY OF ARGUMENT

The decision and judgment of the Circuit Court of Appeals in ordering the dismissal of Debtor's petition filed under Chapter X of the Bankruptcy Act was correct.[5]

I

A. Debtor's petition under Chapter X was not filed in "good faith" as that term is generally and equitably defined, in that minority stockholders, being certain of Debtor's former officers and directors who, by decision of both the Courts below, have no remaining financial interest or equity in Debtor, filed that petition and have since carried on the controversy, including the filing of the petition for writ of certiorari, for their own interests and not those of the contract holders, and all of which has been done entirely by the use of funds belonging solely and exclusively to the contract holders and creditors.

B. The petition was not filed in "good faith" as that term is defined in Section 146(4) of Chapter X, in that the prior proceedings then pending in the States, particularly in West Virginia, would best subserve the interests of the contract holders. Deposits of securities were made by Debtor with each of thirteen States for the benefit and protection of the contract holders in those States, as required by the laws of each of those States. Liquidation and distribution of those deposited securities can and should be performed by the proper officials and under the laws of each of those States, as interpreted by their own State courts, and working in cooperation with the officials of each of the other States; instead of having liquidation and distribution by the Federal Trustee ap-

5 The questions presented, which were raised below but not decided there, are discussed merely cursorily in this opposition brief, and summary thereof is therefore presumed unnecessary.

pointed under Chapter X (rehabilitation of the company being concededly practically an impossibility), and the laws of each of those thirteen depository States being interpreted by the one Federal District Court.

C. As set forth fully in the Statement of Facts and in the Opinion of the District Court (42 F. Supp. at 983), the corporate meeting purportedly authorizing the original filing of Debtor's petition on June 6, 1941, "was not a legal meeting and the directors at that meeting could not grant any valid authority to any person to file the petition for reorganization," and since, as respondents contend, no other valid corporate meeting was held; and since no ratification could be had for the invalid filing of the Debtor's petition; and because the directors enjoined in the Securities and Exchange Commission suit in Detroit in 1938 by acting in violation of Section 9(a) of the Investment Company Act of 1940 were prohibited from performing any valid action, then the petition was never lawfully and validly filed; hence the decision ordering the petition dismissed was correct.

II

A. Sections 156 and 158(4) of Chapter X require that the Trustee appointed by the District Court be disinterested and have no interest in the Debtor or any interest materially adverse to the interests of any class of creditors. Therefore, the instant Trustee has no proper interest in the merits of Debtor's petition, or attempting to sustain it, and no proper interest in attempting to sustain the jurisdiction of the Court appointing it, and consequently no right to apply for a writ of certiorari to a judgment dismissing the petition.

B. Those stockholders who have caused this petition for writ of certiorari to be filed in the Debtor's name have,

by the decisions of both Courts below, no financial or equitable interest remaining in the Debtor and its former assets. Hence, they have no right to continue this controversy for interests of their own, and to do so entirely with funds belonging solely to the contract holders.

I

DEBTOR'S PETITION WAS NOT FILED IN GOOD FAITH

A

Lack of Good Faith as that Term Is Generally Defined

The controversial answer of Edgar B. Sims, Auditor of the State of West Virginia, and the answer of the West Virginia Receivers,[6] sets forth that the Debtor's petition[4] itself shows that those filing it were not acting in "good faith", because the petition, in paragraph IX,[4] states that it is the desire of the Debtor that a plan of reorganization be effected and a Trustee be appointed to formulate it, because the Debtor will be unable to meet its obligations as they mature "unless the rights of the contract holders are modified so that the earnings received on securities and assets owned by Debtor will be sufficient in amount to meet the requirements under its outstanding contracts; if the rights of its outstanding contract holders are modified to this extent, the Debtor will be able to meet its reserve requirements and will be able to resume the operation of its business."

Under *Case* v. *Los Angeles*, 308 U. S. 106, 60 S. Ct. 1, 85 L. Ed. 110, clearly this modifying of creditors rights solely for the benefit of the stockholders could never be

6 These pleadings were part of the record sent by these appellants to the Circuit Court of Appeals, and they, as well as all of the other pleadings, inexplicably are not in the printed record filed in this Court.

permitted under Chapter X, and therefore the petition should have been instantly dismissed.

Sections 141 and 144 require that the petition be filed in good faith, and Section 146, in defining "good faith," specifically does not limit it to the statutory definition.[7]

"Good faith" has been variously defined as "Consists in an honest intention to abstain from taking any unconscientious advantage of another;" "is purely a question of fact;" "the state of mind of the party;" "as the actual existing state of mind."

Black's Dictionary, 2d Ed., 544.
Searl v. *School District*, 133 U. S. 553, 33 L. Ed. 740.

Gerdes, in his article on "Corporate Reorganization," 52 Harvard Law Review 8, states:

> "The judge's satisfaction as to the good faith of petitioners continues to be an essential requirement for approval of petition."

In 48 Harvard Law Review, in the note on pages 287, 289, it is stated:

> "Whatever else 'good faith' signifies, it at least demands *honesty of purpose.*"
>
> "However honest the purpose of the petition, if his primary object is not to protect his interest as a creditor, the petition is not filed in 'good faith'; * * *." (Page 289.)

Most of the writers and judges insist that the *intentions* of those who file a petition must be honest, and that if there is legal or equitable fraud in filing the petition, it

7 The history and background of this phrase "filed in good faith" is set out (R. 118-119). It is submitted that that phrase means *bona fides*.

must be dismissed. Creditors and stockholders who might incidentally be served by such proceedings can then file a proper petition themselves.

In Finletter, The Law of Bankruptcy Reorganization, 35 (1939), the history of Chapter X is set forth, and the author states, as to Section 77B and Chapter X:

> "The reorganization chapters must therefore be regarded as adopting the principles of the equity receivership which was the model for the 1933 and 1934 acts. It is accordingly in the light of these principles, rather than of the liquidation concept which underlies the decision in ordinary bankruptcy, that the reorganization provision must in the main be interpreted."

In 49 Harvard Law Review 1111, at 1123, it is stated:

> *"It is clear that the petitioner must show at least honesty of purpose, motive, and intent."*

Sustaining cases are cited in Note 87, p. 1124.

So "good faith" is merely an extension of the equitable doctrine of "clean hands," a change in nomenclature without any change in substance; and where those filing the petition did not act in "good faith" or *bona fides*, and came into court with "unclean hands," the petition has been dismissed.

In re Northeastern Water Companies, D. C. N. Y., 24 F. Supp. 659.

In re Cook, 104 F. (2d) 981.

Wisun v. *Golub* (2d C. C. A.), 84 F. (2d) 1.

In re North Kenmore Building Corp. (7 C. C. A.), 81 F. (2d) 656.

The West Virginia respondents' controversial answer, filed in the District Court, charges that Marshall, Messick and Fleming dominated the bringing of this instant petition; that their plan was, in bringing a Chapter X proceeding, to have all of the assets taken away from the various State officials and concentrated under one person, a Federal Trustee; that they would then be employed by the Trustee, and be in active charge of that twenty million dollar fund; that they knew, all three being competent lawyers, that there was no possibility of rehabilitation; and that if they originally brought straight bankruptcy proceedings in Federal Court, the lienholders, or State officials, would keep charge of those funds and turn over to the Federal Bankruptcy Trustee only such balances, if any, as were left after the liens were satisfied, that is, the claims of contract holders paid; that under Chapter X proceedings all of the funds could supposedly be collected into the Trustee's hands and that when rehabilitation was thereafter found to be impossible, liquidation would ensue in Federal Bankruptcy Court, with the entire funds collected being turned over en masse to that Bankruptcy Trustee, with the same three gentlemen still in charge of the liquidation and distribution. Thus, by court procedure they would have charge of the liquidation and distribution of more than twenty million dollars, together with the emoluments, fees and expenses therefor.

Such was the charge made in the answer. The facts asserted in these respondents' answer to prove it were: An invalid corporate meeting was held June 3, 1941, authorizing the petition to be filed; the Debtor's petition was filed in the late afternoon of June 6, 1941, by Fleming and Messick, and the Trustee was immediately appointed; that the next morning that Trustee presented a petition to employ Townsend and Townsend as its attorneys and general counsel, which petition the Court granted;

that at the same time the Trustee presented its petition requesting authorization from the Court to employ Messick and Fleming "for the purpose of assisting your Trustee in marshaling the assets of said Debtor which are now situate in divers States outside the territorial limits of the State of West Virginia; also for the purpose of assisting Trustee in the development and formulation of a plan or reorganization for the affairs of Debtor in this proceeding; that your trustee be also authorized by the Court to employ the above named (Fleming and Messick) to perform any other special services other than that of general counsel for the Trustee in the administration of this trust * * *." The Court immediately (June 7, 1941) entered an order granting said petition and authorizing said employment.

At the hearing before the District Court, the above facts being admitted, the respondents attempted to prove that Messick and Fleming were then immediately employed by the Trustee, and the District Court stated from the bench that they had never been employed and he would not permit any evidence to be introduced on that subject. (R. 160, 16.

It was nevertheless brought out in that hearing that at the request of Townsend and Townsend (R. 166), the Trustee's appointed general counsel, Messick and Fleming left immediately for Wisconsin (R. 166) and there conferred with the officials in charge of the deposited securities (R. 153); that they stated that they represented the Trustee and were entitled to act for it (R. 153); that they wanted the Wisconsin officials to work with them (R. 167), and without friction, in turning over the Wisconsin assets to the Trustee (R. 153-154). On the following day Fleming appeared in Chicago before a meeting of the officials of the States which had deposits of securities made by Fidelity (R. 154), and there reiterated that while

he had been originally engaged to look out for Mr. Marshall's stock interests (R. 149), he was there at that meeting speaking to those State officials for and on behalf of the Trustee, at its request (R. 150), and asked those officials to turn over their funds to and cooperate with the Trustee in the prosecution of the proceedings, and conferred with them at length concerning the affairs of Fidelity (R. 150). All of this evidence was undenied by Mr. Fleming and Mr. Messick (R. 154), but nevertheless the District Court held, in its written opinion (42 F. Supp. at 981; R. 16), "Messick and Fleming were never actually employed by the Trustee," and held during the hearing, "Mr. Messick nor Mr. Fleming have ever had any connection with the Trustee." (R. 293.)

After the States objected to the authorization to the Trustee to employ Messick and Fleming, the District Court immediately had such authority concerning Messick revoked, and on August 1, 1941, by written order, had the authority concerning the employment of Fleming revoked, and in his written opinion held (42 F. Supp. at 981; R. 16):

> "The Court at first authorized such employment but later, being of opinion that it would not be for the best interests of all parties concerned, revoked such authority. * * *"

Objection was made to the District Court that the former officials and directors who had been enjoined by the Securities and Exchange Commission suit in Detroit in 1938 could not continue to act purportedly for the Debtor company and dominate its affairs, and that by so doing they were violating the law, in that such was forbidden by the Investment Company Act of 1940, Section 9(a); they were nevertheless expressly permitted by the Court, over such objection, to continue to serve the company

and to dominate its affairs, the District Court holding (R. 22; 42 F. Supp. at 983):

> "I am of the opinion that the fact that certain of these directors may have violated the law in serving as such directors (at the September 17th and October 3rd meetings) would not render their acts as directors invalid."

We submit, the District Court, when so requested, under Section 191, on Oct. 1, 1941, to give these persons so enjoined permission to hold a corporate meeting on Oct. 3, 1941, and re-elect themselves officers and directors, and ratify their invalid action in filing the instant petition, was without authority to permit them to violate Section 9(a), and then to hold their acts in violation of that section, valid.

Their acts in respect to bringing the original invalid petition and their acts in respect to the purported corporate meetings attempting to validate the original filing of the petition, speak more clearly than words as to the honesty of their intentions. The fact that due to the vigilance of the State officials they were prevented from carrying out their plan (R. 162) does not mitigate or excuse their lack of "good faith" in the filing of their original petition.

The District Court's opinion (R. 23) (42 F. Supp. 983) that "there could be no valid action on the part of the directors of the Debtor without the participation of at least some of these allegedly disqualified persons" overlooks the fact that had the equitable and actual owners of this stock ever been permitted to vote it, they could have elected qualified directors who could validly have acted.

We must also respectfully disagree with the District Court's statement (R. 27), to the effect that the fact "the

stockholders of the Debtor had no interest in the assets is immaterial," and submit that such fact was of vital concern to the Court. *Case* v. *Los Angeles, supra.*

It is therefore respectfully submitted that there was a lack of "good faith" as that term is ordinarily and equitably used, and apart from its statutory definition in Section 146, in the filing of the original petition, by reason of which it should have been dismissed.

THE FORMER DIRECTORS, UPON INSOLVENCY, BECAME TRUSTEES OF FIDELITY'S ASSETS FOR THE BENEFIT OF THE CREDITORS, THE CONTRACT HOLDERS

Further substantiating that the directors did not act in "good faith" and that their corporate meetings were invalid, we must further consider the District Court's statement (R. 33-34) (42 F. Supp. at 988) that

> "The fact that some stockholder or director may have been motivated by the hope that he might preserve for the future some connection with the affairs of the company is not in itself proof of bad faith."

and disagree therewith.

By June 3rd the directors knew Fidelity was insolvent, and so stated in the petition filed June 6th (R. 30). In West Virginia, the cases hold that directors of insolvent corporations are trustees of its assets for the benefit of creditors:

> *Pyles* v. *Riverside Furniture Co.*, 30 W. Va. 123, 2 S. E. 909;
>
> *Arnold* v. *Knapp*, 75 W. Va. 804, 84 S. E. 895;

and in Virginia:

> *Triplett* v. *Fauver*, 103 Va. 123, 48 S. E. 875.

Therefore, it was general lack of "good faith" and violation of the equitable "clean hands" doctrine for the directors to do anything which was, or the purpose of which was, for the individual benefit of those directors who were acting as such trustees.[8]

A vote by a director, where he is personally interested, renders the transaction *prima facie* void.

> *Ravenswood Railway Co.* v. *Woodyard*, 46 W. Va. 558, 33 S. E. 285.

> "No member of a board of directors shall vote on a question in which he is interested * * * or be present at the board while the same is being considered * * *."
>
> Code of W. Va., Sec. 69, Art. 1, Ch. 31.

The reason for denying such interested director the right to vote is because of his fiduciary or trust relationship to the corporation.

> *Thurmond* v. *Paragon Colliery Co.*, 82 W. Va. 49, 95 S. E. 816.

A corporation is entitled to have the unbiased and uninfluenced opinion of each of its directors.

> *Tri-State Coal, etc., Asso.* v. *Neace*, 92 W. Va. 196, 114 S. E. 569.

A resolution of a board of directors in which one of their members was personally interested, passed at a meeting whereat that member's presence was necessary in order that a quorum be had, and the member voting in

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8 It is, of course, acknowledged that directors of an insolvent corporation, who act with honesty of intention and purpose, may authorize the filing of a petition under Chapter X.

favor thereof, the resolution is *prima facie* fraud and void.

Sweeney v. *Sugar Refining Co.*, 30 W. Va. 443, 4 S. E. 431.

Flanagan v. *Flanagan Coal Co.*, 77 W. Va. 757, 88 S. E. 897.

Hence, Debtor's petition was not filed in "good faith" and the decision ordering it dismissed was correct.

B

Petition Not Filed in "Good Faith" as Defined in Section 146(4)

Section 146(4), Chapter X, provides that the petition shall not be deemed to be filed in "good faith" if "a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

Since the stockholders had no legitimate interest or equity remaining, the question arises, are the interests of the contract holders best subserved in the proceedings in the States, particularly the State Court in West Virginia, or in the Federal proceedings? This is a fair question and will be met squarely.

Petitioners' brief speaks of the possibility of rehabilitation. In substance, the District Court held liquidation was inevitable, albeit, a slow and orderly one (R. 30, 31). The Circuit Court of Appeals held there was an "immediate need of a liquidation" (R. 383). Counsel for Securities and Exchange Commission, in argument before the Circuit Court of Appeals, was compelled to admit that as a practical matter rehabilitation was an impossibility, and liquidation must ensue.

All testimony to the contrary was by the former officials, subject to being struck for unqualifiedness (T. 3469, 3692), and was pre-Pearl Harbor. Our government now needs the money formerly invested in contracts such as these, to be invested in War Bonds, which are not only a safer investment, but return a higher yield.[9]

Basically, there is only one real issue involved in these entire proceedings, and that question is, *WHO SHALL LIQUIDATE THE SECURITIES HELD IN EACH OF THE THIRTEEN DEPOSITORY STATES, AND WHO SHALL DISTRIBUTE TO THE CONTRACT HOLDERS THE FUNDS RECEIVED FROM THE LIQUIDATION OF THOSE SECURITIES?*

On the one side are these respondents, together with the other depository States and their officials, and on the other side is the Federal Trustee, together with some of the former officers and minority stockholders of the Debtor.

Thus, the subordinate question, is not an immediate liquidation of the assets for the best interests of the contract holders? The States so contend, and are ready to do it. (R. 406, 411, 412.) The opposition contended before the Circuit Court of Appeals, liquidation should be performed slowly and orderly over a five to ten year period. The Circuit Court of Appeals, with the entire record before it, and having twice before,[10] not including informal and preliminary hearings, having had the affairs of this company before it for consideration, one of which cases was an application for receivership on the grounds of insolvency,[10] held with the States that there was "immediate need for liquidation of the company's assets for

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9 See note to C. C. A. Opinion, 324, quoting from S. E. C. Report (Exh. 6 and 12), p. 113.

10 *Hutchinson* v. *Fidelity Investment Assn.*, 106 F. (2d) 431, and *Sims* v. *Central Trust Co.*, 123 F. (2d) 89.

the benefit of contract holders" (R. 383), and their interests would be best subserved in the prior State proceedings then pending in the State Court in West Virginia (R. 386).

The opinion of the Circuit Court of Appeals sets forth in a footnote (R. 365) the fifteen States having a deposit made by Debtor, the amount of that deposit and its legal nature in each of those States, and the statute of each of those States under which the deposit was made.[11] Actually, however, there are only thirteen true depository States.[12] In each of these thirteen States there is an actual deposit of securities held by the State, or some of-

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11 The Securities and Exchange Commission, pursuant to Section 30 of the Public Utilities Holding Company Act of 1935 (R. 366), made an investigation of "Investment Trusts and Investment Companies," which was from time to time printed and submitted to Congress in correlated parts; this particular Debtor was one of those companies investigated and reported on (R. 384), beginning in June, 1938, there being at least six such partial reports. Exhibits 6 and 12 of the case at bar dealt especially with the instant company (R. 130, 384). In Appendix W thereof, at pages 179-196, there is set out a brief summary of the laws of the various States showing their requirements for deposits, the statutory official placed by law in charge of such companies, and many of the regulations and safeguards placed by the States around the sale of contracts of this nature, and around the continuation of safeguarding the interests of the investing public in such companies.

12 Briefly, in Virginia the State Corporation Commission, acting under Section 5 of the Virginia Securities Law, required Fidelity to post a bond, payable to the Commonwealth, the conditions of the bond being set out in Section 5(r), which was to protect against selling claims, and was not a depository bond in any sense of the word. In lieu of surety on the bond, the State accepted $25,000.00 in government bonds which has been loosely, but incorrectly, referred to as a deposit in Virginia.

Pennsylvania required a $100,000.00 deposit as a prerequisite to doing business in that State, and later required protection for a certain few of the contract holders. These funds are in the nature of a true deposit, and were held by the State Banking Commission. However, immediately after the West Virginia State Court receivership was instituted, and prior to these Federal proceedings, equity receiverships were set up in both the Eastern and Western Districts of Pennsylvania, both of which are still in existence; the Western District receivership having approximately $10,000.00 in its possession, and the Eastern District receivership, by virtue of an order of that Court, took from the State Banking Commission in the Middle District of Pennsylvania all of the funds in its possession, approximately $232,000.00; and has since retained them, so that in Pennsylvania there is in actuality no deposit with the State or any official thereof.

ficial thereof, in the amounts as set forth in the opinion below (R. 366), each of which deposits is still retained by the depository State (R. 371).[13] There are *less than five per cent.* of the Debtor's former assets, *which are not held* by the depository States; that is, the *States hold over ninety-five per cent.* of all assets.

Let us now examine the reasons underlying the decision of the Circuit Court of Appeals.

On the side of the States, first, these thirteen States, beginning with West Virginia, in 1911, through their legislators, were sufficiently interested in their own people, and in the investments which those people made, to pass regulating laws for companies such as Fidelity, and were sufficiently interested in the protection of their people to require Fidelity and others to make a deposit with that State, or some official thereof, which was to protect, fully in most cases, the investors in that State in case Fidelity failed and became insolvent. The record shows these officials performed their required duties.

On the other hand, the Federal Government took no interest in these companies such as Fidelity until in 1935 the Securities and Exchange Commission was required, under the salutary laws passed concerning that body by Congress, to investigate these companies, report to Congress thereon, and recommend legislation therefor (R. 366). This the Securities and Exchange Commission fully and ably did, and among those laws passed was the

13 The West Virginia Receivers took into their possession undeposited securities and cash located in West Virginia, which, including escrow payments made by contract holders, amount to somewhat less than one million dollars. This, by order of the District Court, and over objection and protest of those State Court Receivers, was required to be turned over to the Central Trust Company, Trustee, in whose possession it has since remained (R. 371). There is still a deposit with the State of West Virginia, under the control of Auditor Sims, of more than $10,000,000 which was never turned over to the Federal authorities.

Investment Company Act of 1940, to take effect January 1, 1941.

But this Act was to apply for the future as to those companies and was not particularly concerned with the past, and *specifically* was not to disturb the deposits already made in the various States, but only such deposits as were made after the effective date of January 1, 1941 (R. 229). No deposit was made in any State by Fidelity after that date.

When it became apparent that the Debtor could not continue as a going insurance company, Mr. Sims, the Auditor of West Virginia, on March 25, 1941, advised the company, by a written letter (R. 139) that he was giving serious consideration to asking State Court statutory receivership for them, and asked them, however, to investigate the possibility of the company being placed in Federal Court under the Federal Bankruptcy Act for the purpose of determining whether it could be reorganized under that Act.

After a full and free discussion of the matter in a two-day session of the board of directors, a unanimous expression in favor of State Court proceedings was adopted,[14] and the Debtor was represented in those State Court proceedings thereafter instituted by the Auditor and made no objection thereto.

Until Mr. Fleming took the position that the Federal Court should take jurisdiction, some weeks after the State Court proceedings were instituted, no one else ever took that position (T. 3608).

After Auditor Sims instituted his statutory proceedings on April 11, 1941, in West Virginia, he advised the

14 See Exh. Minutes of Board of Directors' Meetings, Apr. 7-8, 1941, pp. 173-4; see also T. 2592-97, 2605-06, Testimony of F. s. Risley, Pres. of Debtor; T. 2774-76, 2228-29, Testimony of Tom B. Foulk, Atty. for Debtor.

other depository States of his action, and protective proceedings were instituted by State officials in other States.

In West Virginia two Receivers, respondents herein, were appointed. In the less than two months they were permitted to act, they made a list of all of the contract holders, together with all necessary data concerning each contract, including the amount due under each contract less any loan values thereon, and segregated by states; a complete and accurate account of all of the assets and funds of Fidelity, including the amount of each State deposit; notified the contract holders of the proceedings; kept in touch with the other States' officials and their proceedings; and had a nebulous plan beginning to form for voluntary reorganization.

On the other hand, the Federal Trustee has done nothing constructive since it was appointed except to hold the funds taken over by the District Court's order from the West Virginia Receivers, and to aid the Debtor in this controversy to retain the Federal Court jurisdiction. A partial report under Section 167 was filed. It contained only data previously prepared for the State Court receivership. Lists of creditors and assets of the company were filed, taken verbatim from the State Court receivership files by one of those State Receivers, who was and is now employed by the Trustee to manage the home office of Fidelity in Wheeling. Just a year ago the Trustee was ordered to have completed, by the District Court, its Sec. 167 report and to file it and as yet this has not been done. The respondents, on many occasions, have demanded its completion, and on just as many occasions were told by the District Court that it did not concern them, and the Trustee would file it when it was ready.[15] It has not yet been filed.

15. Particularly written motions by the Tennessee and West Virginia State Court Respondents, and orders thereon, included in the record sent the C. C. A.; not found in the printed record for this Court.

True, Auditor Sims of West Virginia originally desired and hoped to reorganize Fidelity, and the State Court Receivers were working towards that end. They attempted to get the Federal Court suit dismissed as quickly as possible, knowing that delay in reorganization proceedings is fatal. It has been. Fidelity is now as dead as the Pharaohs of Egypt. These respondents have so said, and still so say, ever since it became apparent that this was to be a lengthy controversy.

From the time the Federal proceedings were instituted, these respondents requested of the Debtor, and demanded of the Trustee, that a plan be filed, or any ideas of a plan, if any they had, as quickly as could be done. To date there has not been filed by the Federal Trustee or the Debtor one scrap of paper giving any indication of any possible, let alone probable, plan. Petitioners' brief herein gives no further or better information in that regard.

As the Circuit Court of Appeals said (R. 385):

> "Certainly it would be unjust and unreasonable to delay satisfaction of their (contract holders) claims in order that an illusory hope of reorganization may be entertained."

Next arises the subordinate question as to how the depository laws in the various States can best be interpreted. The position of the respondents and the other depository States is that each State can best interpret its own depository laws, and distribute the funds to the contract holders in that State entitled thereto, and any balances remaining they have definitely agreed to turn over to West Virginia, and should their contract holders not be paid in full, to look to the West Virginia fund for any balance due.

Those advocating Federal jurisdiction maintain that the District Court for the Southern District of West Virginia can better interpret the depository laws of each of the fifteen States than can the Courts of those States; that as well there are myriad problems of law to be settled in that Court which will take years of protracted litigation to decide. These problems are such as the "Series Trust Fund" theory, "Company Interfund Loans", "Geographical Location" ideas, "Change of Residence by Contract Holders", "Trust Fund Under State Line" theory, "Jackpotting all of the Funds Generally", "Jackpotting Under Geographical Lines", "Jackpotting Under Series", and such other legal theories. (Petitioners' brief, p. 42-43.)

The States refuse to recognize any such theoretical legal problems. Their statutes to them are plain that the deposit was made in each State for the benefit and protection of the contract holders of that State, and that those persons, and those only, are entitled to those funds, and the Circuit Court of Appeals, certainly a most competent and, particularly about the affairs of the instant company, a very informed Court, so held.

A brief reading of the State statutes, or even the brief quotations therefrom contained in the note to the Circuit Court of Appeals opinion (R. 365) will resolve all legal doubts.

The petitioners say that they are not "to answer or resolve these questions" they raise "they are suggestions demonstrating the necessity of withholding any distribution" (Petitioner's Brief, p. 44); on the contrary, the *STATES CAN, HAVE AND WILL ANSWER AND RESOLVE THESE QUESTIONS,* and in the majority

of instances have already done so. Red tape can, has been and will be cut to pieces.[16]

These respondents and the other depository States tend to the practical side of the law rather than the theoretical. With the exception of Pennsylvania and Virginia, whose position has been above and below explained, of the thirteen remaining depository States, six are respondents here. The other seven have advised counsel preparing this brief that they are in thorough accord with the position of these respondents and that, if it is possible so to do, they will so state in opposition briefs to be filed amicus curiae. In other words, all thirteen depository States are in perfect and harmonious agreement in opposition to those advocating Federal jurisdiction.

The Record (pp. 406-413, inclusive) contains letters to and from these respondents. Within thirty days from the handing down of the decision by the Circuit Court of Appeals, every one of the fifteen depository States, including Pennsylvania and Virginia, through their proper State officials, met in Charleston, West Virginia, July 9-11, 1942, and amicably discussed and *settled* their mutual problems. Each State, cooperating with each of the other States and the officials thereof, and with committees appointed therefor, will liquidate and distribute its own deposited fund to those rightfully entitled thereto. The quotation from the West Virginia letter (R. 406-7) and again (R. 410), the quotation from the Mary-

16 As stated so ably recently by Assistant Solicitor General Oscar Cox, "Boldness and imagination rather than dependence on archaic legalism" must govern the action of lawyers in War times. The responsibility of lawyers is to find affirmative ways by which decisions of policy makers can be promptly fulfilled. * * * "Intelligent inquiry will prompt many a lawyer to say 'Yes' or 'Go ahead' where traditional conservatism has always dictated 'Stop' or 'Caution'. Our lawyers must be sufficiently bold and imaginative to explore this new realm of freedom—to discover what the law *can do* as well as what it can prohibit."

land letter (R. 411-12), the quotation from the Iowa letter (R. 412-13) show clearly how the States have, can and will cooperate together.[17]

Thus, the question of liquidation has already been settled by and between the States.

A committee was formed which has prepared uniform proofs of claims for each of the depositor States and as well for Pennsylvania and Virginia, and a form for claims over against the West Virginia fund. Some of that group later met counsel for the petitioners, when a stay of mandate was requested of the Circuit Court of Appeals, and that group, as a condition to the stay, obtained a consent order, dated July 22, 1942, modifying the District Court's order of August 9, 1941, so as to permit the proper officials of the depository States the right to service those deposited funds and to permit them to send out and receive proofs of claims, and to perform other administrative functions looking towards a future distribution of the estate.

Since then they have proceeded to service those funds, collect interest thereon, sell some of the more risky securities, and put uninvested cash into interest bearing United States Government securities.

Not only has a uniform proof of claim been prepared, but it has been agreed to and adopted by each of the de-

17. The West Virginia letter (R. 410) shows the agreement that sales of securities would not be made, pending the decision of this Court, merely for the purpose of liquidation, but only for other good and sufficient reasons. The Maryland letter (R. 412), stating that they "expect to work out *mutually satisfactory arrangements with other interested State officials* to dispose of the securities as advantageously as possible"; the Iowa letter, showing that individual liquidation would not be had until it was determined by a committee appointed by that conference group, whether it would not be more advantageous to sell the assets as a whole; further statement from the Iowa letter: "Iowa, as agreed at the conference, does not intend to step out of bounds on the liquidation, but will go along with the rest of the States *in order that the best interests of all may be obtained.*"

pository States, and distributed to the officials of those States. At the time this opposition brief is being written, the administrative machinery in every single one of the depository States is in action, either preparing to, or already having sent out a proof of claim to each contract holder in that State; West Virginia sending out proofs of claim to all State contract holders having no deposit in their own State, but who, under the laws of West Virginia, will look to the West Virginia fund for their protection. This, by agreement between officials, includes Virginia. Each of the depository States, as well as sending and receiving a proof of claim against their own State deposit, will forward to the contract holders and receive from them a proof of claim for any deficiency in that State fund which will necessitate a claim over against the West Virginia fund.[18] The *State officials* will collect all of these claims over against the West Virginia fund and they will be turned over en masse to the West Virginia officials, who will accept them, file them, and consider them as pro rata claims against the West Virginia fund.

Thus, the theoretical ideas of Petitioner that the contract holders will "*be required to file claims in the courts of many States*" (Petitioners' Brief p. 43), has been overruled by the practical applications of law by the States, as set out above, and other than those whose claims disagree with that which is shown on the books of the Debtor company, no contract holder will be required to do anything other than sign his name, under oath, to not more than two proofs of claim, one against his own State fund and the other against the West Virginia fund for any deficiency in his own State fund, and return those in one

18 The Attorney General and the Banking Commissioner of Pennsylvania are working cooperatively with West Virginia officials to work out the situation in Pennsylvania, which will shortly be accomplished.

stamped self-addressed envelope, *to the statutory official in his own State.* Perhaps the simpleness of this plan has confused those in opposition to the States' position.

By the time this case is before this Court this matter will in all probability have been finished. So much for the impossibility of the States being able to perform that function.

There will be none of the fanciful and theoretical legal questions in the State proceedings which Petitioners claim to be necessary for the settlement of this estate (Petitioners' Brief p. 42-43). If at any time the legal interests of two or more States are, or appear to be, in conflict, agreements at the Charleston conference were entered into as to who the parties shall be, that their representation shall be by State officials, and the proper authorized legal forums have been selected. By declaratory judgments, advancement of the case for hearing and other rapid means of legal determination, these administrative problems will be submitted to the proper State Court, both sides being represented amicably, but earnestly, by their proper State officials, and a decision as to the legal rights involved will be promptly obtained and followed. We believe that the State Court in the State wherein such legal determination is necessary is better able to decide on the law of that State, and this being so for each of the fifteen States, than can one Federal Judge in Southern District of West Virginia, however learned he may be.[19] So did the Circuit Court of Appeals. (R. 386.)

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19 Since the States have possession of the deposited securities and claim title to them, and in most instances have title, it may well be that should Federal jurisdiction be upheld, there would have to be brought by the Federal Trustee fifteen plenary suits in fifteen States, to attempt to recover possession of the deposited securities, thus adding to the perplexity of undecidable questions in Federal proceedings.

Thus, in less than thirty days from the handing down of the decision, a meeting (Charleston, W. Va., July 9-11) was held and matters settled and determined, and within two months, these State officials have proceeded with and performed that which the Federal Trustee, in fifteen months, is still studying about and wondering how to do, and which the Petitioners say cannot be done. In Federal Court there has as yet been no move made to have claims proved, or other than theoretical plans laid down as to how it shall be done.

Let us now look at the personnel of each side. In each State the deposited securities were under the custody and control of an official of that State. In most of the States the Attorney General has acted in the State proceedings as the official representative of that State officer (West Virginia, Illinois, Wisconsin, Delaware, Alabama, Kentucky, Pennsylvania, Virginia, Ohio, Indiana, Maryland), and in the others has acted in an advisory capacity (Iowa, Kansas, Missouri, Tennessee).

In most of the States statutory actions have been instituted in proper State Courts, and the officials of those States are acting under the judicial guidance of those State Courts.

These respondents, although widely separated geographically, have worked amicably, interestedly, and purposefully together. They have divided the onerous duties of this litigation among themselves, some acting in Court as trial examiners, others making a research of the law and cases, others preparing motions, briefs, and other legal papers; they prepared and carried out successfully a joint and several appeal to the Circuit Court of Appeals; they briefed the matter separately, some States acting jointly, but by agreement legal points were apportioned among the various States, and their individual

efforts, without duplication, presented one joint brief in a united front. They are again attempting to do that in this Honorable Court.

This is the practical and working answer of the States to those opposed to them, who have contended that the States cannot and will not work together, and that it is necessary to have one central authority or control of the entire matter, that one to be a District Court, for all problems of law, and the other a private trust company and its attorneys, for the remaining matters.

In answer to the District Court's opinion in the *National Surety* case (Petitioners' Brief p. 45) in which he regretted being unable to exercise his salutary jurisdiction over the reorganization of that company, need it be said that that company, acting under State Insurance Commissioners and State Courts, has been successfully reorganized, and done so in a far less time than the five to ten years claimed needed here.

Some judges seem surprised to learn that there have been a large number of insurance companies in the United States reorganized successfully and as going concerns, and others liquidated successfully, and that every single one of these, without exception, has been done under the supervision and jurisdiction of the State statutory officials and the State Courts, either in a single State or in many States, acting jointly and cooperatively together. The experience of these States stands them in good stead in solving problems such as the instant one, and we submit they have demonstrated that experience by their actions to date.

On the other side, we have a private trust company with no experience in these matters, which is limited to trust work only and not even to the banking business. True, it has employed one of the West Virginia Receivers to head

its home office there, has hired and kept on its payroll "financial advisors" and "investment counsel", and has had capable counsel appointed by the Federal Court for it, yet who still consults private counsel, and whose private counsel are now the Debtor's attorneys presenting this petition. It applied for an interim allowance of $22,500.00 as part payment for nine months' labor of holding and servicing less than one million dollars, at least fifty per cent of which is cash. All other expense, including the "experts" it hired, even to the filing clerks of its own company, have been paid from the funds of the contract holders in its possession, by virtue of orders of the District Court. The hearing had on these fees was after argument of the case to the Circuit Court of Appeals, and the Trustee was paid during that period, before the decision was rendered, the sum of $18,000.00 as interim allowance as part payment for this work, over objection of these respondents. True it is that the Trust Company, although supposedly a disinterested trustee, has entered this litigation and has attempted to sustain Debtor's petition and the jurisdiction of that Court which appointed it, and filed a brief in the Circuit Court of Appeals, and is now joining as a party to the presentation of this petition.

Therefore, it is respectfully submitted that not only can the contract holders' interests best be subserved by continuation of the proceedings in the States, but that they, by their actions and work, have rendered moot all of the supposedly difficult Federal questions raised in Debtor's petition. By practical application of the law by these experienced State administrators, they have performed everything which need be done in these proceedings except sell the securities and distribute the funds. They are prepared at the present time, and have offers of purchase for all or various parts of the deposited securities

which can be accepted immediately. There will then be left only the task of distribution, which will be accomplished just as rapidly as possible, and in conformity with the speed with which they have acted in the other matters where they have been permitted so to do.

It is therefore urgently requested that this Court as quickly as possible dismiss the petition and allow these respondents, and the other States associated with them, to distribute the money as quickly as possible to the 87,999 contract holders, to whom it belongs and *who so earnestly desire it*, and who eagerly await the decision of this Honorable Court permitting them to obtain it.

C

Debtor's Petition Was Never Validly Filed or Ratified and Could Not Have Been Validly Ratified

As to the three purported meetings of the Debtor or its directors (June 3, September 17, and October 3, 1941), that of June 3rd was invalid and was properly so held by the District Court (R. 21; 42 F. Supp. at 983).

It was necessary for the directors to have a lawful and valid corporate meeting to authorize or ratify filing the petition, and that which a majority of them, acting in an invalid corporate meeting or acting in their individual capacity, did is not legally binding. They could act only as a body, their power not being joint and several in West Virginia, only joint.

McRealty Co. v. *Beckley Hardware Co.*, 107 W. Va. 290, 291, 148 S. E. 122.

Pennsylvania Line Road Co. v. *Board*, 23 W. Va. 360.

Craft v. *Blackwater Boom, etc., Co.*, 46 W. Va. 56, 64, 33 S. E. 125.

Lawrence v. *Montgomery Gas Co.*, 88 W. Va. 352, 357, 106 S. E. 890.

Fleming was clearly not entitled to participate in the Pittsburgh meeting because, even though a person may be elected a director, before he can perform any such duties, where a stock holding is a requirement, he must qualify by becoming a stockholder.

Triplex Shoe Co. v. *Rice*, 17 Del. Ch. 356, 152 Atl. 342, at 351.

Where a board of directors consists of nine members and two resign, four members do not constitute a quorum to fill vacancies. The law requires a majority to transact business.

Mecleary v. *Mecleary, Inc.*, 13 Del. Ch. 329, 119 Atl. 557.

Where by-laws provide the board of directors shall consist of seven, a majority to constitute a quorum, the vote of three directors is not a quorum where there exist four vacancies.

Bruch v. *National Guarantee Credit Corp.*, 13 Del. Ch. 180, 116 Atl. 738.

The meeting of September 17th was equally invalid, and it is submitted that even Mr. Ray, Debtor's attorney, so recognized this in seeking permission for the meeting of October 3rd, and actually abandoned any contention as to its validity (T. 2261, 2263). The District Court sustained the validity of the September 17th meeting on the ground that one who, without his knowledge or consent,

is elected a director, and who thereafter immediately, in writing, refuses to accept the position, is nevertheless a director until his "resignation" is accepted by the board that elected him. That this proposition is fundamentally unsound is so apparent as not to require citation of but a few of many authorities.

13 A. J. 858, Sec. 87; 868, Sec. 885; 867, Sec. 883.

Fletcher on Corporations 71, Sec. 314.

Briggs v. *Spaulding*, 141 U. S. 132, 35 L. Ed. 662.

West Leechburg Steel Co. v. *Smitton*, 280 Mich. 180, 273 N. W. 439.

The District Court held that the unauthorized filing of a petition by officers of a debtor under Chapter X was an act that could be ratified (R. 23) (42 F. Supp. 984). It is submitted that that action is so serious that ratification should never be permitted; also, ratification of a previously unauthorized act by a director then beneficially interested, would stand on no higher plane than the original act.

Thompson v. *Laboring Man's Mercantile Co.*, 60 W. Va. 42, 53 S. E. 908.

The law appears plain that there is no presumptive authority in any officer to file such a petition without special authority therefor.

Gerdes on Corporate Reorganization, Volume I, Section III, pages 264, 265, states:

> "There is no presumption that any officer of a corporation, even its President, has power to authorize the filing of a voluntary petition in bankruptcy. The filing of such a petition is not part of the ordinary conduct of the business of the cor-

poration and therefore requires special action by its board of directors or its stockholders, unless an officer is given express authority for that purpose in the corporate by-laws or certificate of incorporation."

In re Jefferson Casket Co. (D. C. Ky.), 162 F. 689.

In re Community Book Co. (D. C. Minn.), 10 F. (2d) 661.

Regal Cleaners & Dyers v. *Merlis* (C. C. A. 2d), 274 F. 915.

Any such unauthorized filing of a petition purportedly on behalf of a debtor will result in its dismissal.

In re Joseph Feld & Co. (1941), 38 F. Supp. 506.

The objections which were made in the District Court to the validity of the meeting of October 3rd, to-wit, that the District Court could not under Section 191 of Chapter X give permission for a violation of Section 9(a) of the Investment Company Act of 1940; that the majority of those requested to be elected directors and officers were subject to that injunctive order in the Securities and Exchange Commission suit in Detroit in 1938; that the Court refused to permit the equitable owners of the stock to vote it; that no listing was made of the stock represented by the stockholders present (T. 3000); that the Court rejected the suggestion that a disinterested person be present at those meetings (T. 2281); that John Marshall, as trustee, in violation of the state laws of West Virginia (Code 31-1-73) and in violation of all equity and fair play, voted 9570 shares out of 9887 shares to ratify his own acts and activities; and that those elected to the board of directors were his relatives and others subject to his own bidding, is sufficient, we submit, to sustain

the proposition, without further argument, that there was no valid and legal corporate meetings; and thus never any valid ratification of the invalid meeting of June 3, 1941, and consequently there has never been any valid corporate authority for the filing of Debtor's petition in these proceedings.

II

PETITIONERS CANNOT RIGHTFULLY FILE PETITION FOR WRIT OF CERTIORARI

A

Trustee Has No Right to File Petition

Section 156 of Chapter X provides that the Trustee appointed shall be disinterested.

Section 158(4) provides that such a person shall not be deemed disinterested if it appears that he has, by reason of any direct or indirect relationship to, connection with, or interest in the Debtor, an interest materially adverse to the interests of any class of creditors. There is only one class of creditors in this case, that is the contract holders.

Throughout the hearings of the District Court, the Trustee's appointed attorneys engaged in that jurisdictional controversy on the side of the Debtor, undertook to sustain the Debtor's petition and the jurisdiction of the District Court, over numerous objections and exceptions of these respondents, that is the depository States and the contract holders. (T. 3620, 3625, 3634, 3642, 3644.)

The Trustee, through its appointed attorneys, filed a brief in the Circuit Court of Appeals attempting to sustain Debtor's position, and in opposition to that of these respondents. The West Virginia appellants therein chal-

lenged the right of the Trustee and its attorneys to appear on behalf of the Debtor, and their right to attempt to sustain Debtor's petition and the jurisdiction of the District Court, and moved to strike that brief from the proceedings (R. 358). This motion was not acted upon by the Circuit Court of Appeals.

It is undisputed that Mr. Ray and Mr. Holt, the capable attorneys now representing Debtor, each belong to a firm of attorneys each of which is general counsel for Central Trust Company, the Trustee herein.

Therefore, it is submitted that the Trustee has, in violation of the provisions of Chapter X, not been disinterested; has been interested in the Debtor, both directly and indirectly; and has shown, and is showing, an interest adverse to the contract holders, the true creditors herein.

The only decided case on this question holds that the Trustee has no right, in circumstances such as these, to apply for writ of certiorari.

Loomis v. *Gila County*, 103 F. (2d) 312, Certiorari denied, 307 U. S. 643.

"The trustee is not concerned with the merits of the petition under Section 77B or its dismissal."

And its appeal from a dismissal of a debtor's petition was refused.

Therefore, the Trustee is not a proper party to the petition for writ of certiorari in the case at bar.

B

Those Purporting To Act for Debtor Have No Right to File Instant Petition

INTEREST OF DEBTOR IN THE APPLICATION FOR WRIT OF CERTIORARI

Other than as set forth herein above, there has been no corporate authorization by the Debtor for filing the

petition for writ of certiorari, nor for attorneys to appear in its behalf, and no corporate authority for its present attorneys to act in its behalf or to represent it. Apparently John Marshall, acting under the resolution which he himself passed by virtue of the stock trusteed in him, is employing attorneys and spending money belonging to the contract holders in carrying on this vain and useless controversy.

Therefore, there having been no valid meeting of the Debtor corporation before the petition was filed, and the act being such a one that it could not and should not be permitted to be ratified, and the attempts to ratify it being unlawful and invalid, the original petition was invalidly filed, the filing thereof was never validly ratified, and therefore the judgment rendered by the Circuit Court of Appeals should not be disturbed.

As set forth in the District Court's opinion, the Debtor is insolvent in a bankruptcy sense, in that on the basis of market values its liabilities exceed its assets by approximately ten per cent. (R. 30) (42 F. Supp., at 986).

Those stockholders who are attempting to continue this controversy, on the witness stand, stated emphatically not only that they had no new money themselves to invest in the company, but that for several years prior to the institution of these proceedings vigorous attempts had been undertaken to procure new capital, and every means tried was unavailing (R. 384).

For the stockholders to participate in any plan of reorganization under such facts as these, that participation must be based on a contribution in money or moneys worth. Mere management or agreement for further management is not sufficient. *Case* v. *Los Angeles, supra.*

In the case at bar, however, the District Court repeatedly reiterated that those who had formerly been the

managers of the company and been in control thereof would never be permitted by the Court in the future to participate in its management or its affairs.

> "To hold that in a 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders, because apart from rehabilitation under that section they would suffer a worse fate (liquidation), would disregard the standards of 'fair and equitable;' and would result in impairment of the Act to the extent that it restored some of the conditions which the Congress sought to ameliorate by that remedial legislation. * * * junior interests must be excluded unless they furnish adequate consideration for the interest which they obtain in the new company."
>
> *Case* v. *Los Angeles Lbr. Products Co., supra:*

Therefore, under the ruling of this Court in the *Los Angeles* case, these stockholders can never participate in any reorganization as under the rulings of the District Court and the Circuit Court of Appeals, they have no equity remaining.

It is therefore submitted that they have no legitimate interest in petitioning this Court for a writ of certiorari, using Debtor's name therefor, particularly as even under the apparent decision of the District Court the only possible future in Chapter X proceedings for Fidelity is a liquidation, even though slow and orderly.

Stockholders' Plan to Obtain Contract Holders' Funds

We use the word "legitimate" above advisedly, because these respondents contend that these stockholders are motivated by unfair and inequitable reasons in attempting to retain the proceedings under Chapter X.

While both the Courts below have held there is no equity remaining for the stockholders, yet it is submitted that such is not their belief, and an examination of Chapter X discloses why the stockholders are so interested in retaining these proceedings, while paying lip service to the phrase "for the best interests of contract holders."

Section 204 of Chapter X provides that upon distribution, which should, of course, be a part of the District Court's stated idea of a slow and orderly liquidation, the judge may fix a time, not sooner than five years after closing the estate, after which no claimant or stockholder shall participate in distribution under the plan.

Evidence was offered, and we think it is a recognized fact, that of the 87,000 contract holders, a certain percentage would file no claim or would be impossible to locate. Should this number be even as low as twenty per cent, and should the rest be paid in full, of the approximately twenty million dollars of Fidelity's assets, this could leave four million undistributed.

If the Debtor were reorganized by way of rehabilitation, as these respondents insist is the only correct interpretation of Chapter X, this undistributed sum would be transferred to the rehabilitated corporation, and consequently to the benefit of the contract holders, the only true creditors.

Under the District Court's theory of slow liquidation, and not rehabilitation, under Section 205 of Chapter X, it is provided what would be done with this undistributed sum.

> "The securities or cash remaining unclaimed at the expiration of the time, as provided in Section 204 of this Act, or any evidence thereof, *shall become the property of the debtor* or of the corporation acquiring the assets of the debtor under the plan, as the case may be, free and clear of any and all claims and interest."

There is no exception made to this section, and since there would be no new corporation acquiring Debtor's assets under the plan of a slow and orderly liquidation, this sum of at least four million dollars would be RETURNED TO THE DEBTOR, which, in this case, means the STOCKHOLDERS.

It was earlier presumed that since the District Court had frequently reiterated throughout the hearings that the stockholders had no interest in the Debtor's assets, that the District Court would take means to prevent this occurrence from happening.

However, a decision by the District Court on June 11, 1942, in *Sanders* v. *Chandler*, U. S. D. C. E. Pa. (Moore, D. J.), 11 Law Weekly 2040 (being the same Judge who decided the case at bar in the District Court below, being assigned to Pennsylvania temporarily), leads to the inevitable conclusion that the result which the stockholders seek, that is, the escheat to them of the funds belonging to the contract holders, would be decided in their favor by that District Court.

In the *Sanders* case the District Court held, with reference to an insolvent National Bank, and a Pennsylvania statute providing for escheat to the State of unclaimed funds in the hands of such a receiver, that such statute is invalid.

The Court's reasons were that unclaimed funds were not actually such, "unless the total moneys in his (the Comptroller's) hands be more than enough to pay in full the creditors who have proved claims." Merely because some depositors failed to make a claim does not necessarily result in unclaimed funds, nor does it serve to earmark particular funds as property of such depositors.

> "All of the funds on deposit in the bank, other than those held in trust, belong to the bank, and

upon insolvency are to be distributed ratably by the Comptroller to the creditors who prove their claims under the law. Only in case a surplus exists after proven claims have been paid in full may a receiver for a National Bank be said to have unclaimed funds in his hands. As I have already pointed out, even this surplus *must* under the federal statutes be *distributed to the stockholders*. * * *"

The States who have these funds on deposit can hold them indefinitely for the contract holders. In any event, it is submitted that since the contract holders stand to suffer loss by virtue of any market or other depreciation of the deposited securities, that the deposited fund belongs entirely to the contract holders, and they should receive any appreciation in it, by any means whatsoever, and in no event should the stockholders be permitted to share in the deposited funds.

All of the costs and expenses of these proceedings under Chapter X, including all of the Debtor's expenses for summoning of witnesses, paying transportation therefor, paying of court costs, expenses of counsel, not including counsel fees, payment of costs of printing records and briefs, have been paid out of the funds in the hands of the Trustee which belong exclusively to, and should be for the benefit of, the contract holders alone.

Since it is apparent that the stockholders who are applying, in the Debtor's name, for the issuance of a writ of certiorari have no equitable interest in the Debtor's former assets, and are by the above indirect and subtle means attempting to accumulate for themselves in the future a really substantial sum of money which, as well, belongs solely to the contract holders, they should have no standing to file their petition in this Court.

And since these stockholders were the former directors of the Debtor, and as such trustees for its assets on insolvency for the benefit of the same contract holders, and since their purported corporate activities were in violation of their trust or fiduciary duties, and since their attempts to accumulate a fund for themselves in the future could not and would not happen in the event the State proceedings are continued, it is respectfully submitted that this Court should deny the petition for writ of certiorari and permit the judgment of the Circuit Court of Appeals dismissing the purported Debtor's petition filed in the case at bar to be carried into effect.

ADDENDUM

There were certain other issues raised in the District Court (42 F. Supp. 981) by these respondents which were briefed and argued to the Circuit Court of Appeals (R. 363), which latter Court neither discussed nor decided these questions (R. 363), but which, it is submitted, were of such substantial intrinsic worth that they would support and uphold the correctness of the decision and judgment of the Circuit Court of Appeals in and of themselves.

III

Deposits of securities were required to be made by Fidelity by the laws of each of thirteen different States and such deposits were so made. These deposits were made either with the State itself or with an official of that State, usually as Trustee for the benefit of contract holders in that particular State. It is contended, especially where the deposit was made with the Sovereign State itself, as in West Virginia, the officials of those States, such as the West Virginia Auditor, who had possession, custody or control of those deposited funds, are protected from suit, order or the jurisdiction of the District Court by the Eleventh Amendment to the Constitution of the United States, and clothed with immunity thereby, so that they and the deposited funds were not subject to the jurisdiction of the District Court in these proceedings.

Under Code of West Virginia, Chapter 33, Article 9, Section 3, it was provided for the Insurance Commissioner to require a deposit with the State Treasurer from such companies as the Debtor, *"in accordance with Article 5, Chapter 12"* to be held in trust for the benefit

of contract holders for their security; and Section 2 of that latter article and chapter provides that the Treasurer of West Virginia "shall be the custodian of all securities belonging to the State of West Virginia *or required to be deposited with the State.*"

The various laws of the other States required deposits of securities to be made either with the State itself or with some official of the State, for the benefit and protection of the contract holders, and in many instances, with an actual transfer of title to the securities. In West Virginia, after Debtor's license was revoked or expired, which it admittedly did no later than April 4, 1941, the deposit was to "remain under the authority and control of the Insurance Commissioner", who is the Auditor (Code W. Va. 33-9-10).

By virtue of this section and by reason of the S. E. C. report (Exhibit 6 of the instant case) at page 124, Note 12[20] even the residual interest, if any[21], of the Debtor in the deposited securities, no longer remained on June 6, 1941, the date the petition was filed.

Therefore, these respondents have contended, and still contend that, by virtue of the Eleventh Amendment to the Constitution of the United States, the District Court had no jurisdiction over either the deposited funds or over that Sovereign State which required a deposit, or the State official who had custody and control and administrative charge thereof.

Restatement of the Law of Trusts, Sec. 95, p. 264[22].

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20 "In the collateral trust, face-amount certificate, the securities are pledged merely to secure the company's obligation, and the company has a *contingent right* in the securities so deposited and their earnings SO LONG AS ITS OBLIGATIONS ARE DISCHARGED."

21 On the basis of market values, Debtor has had no residual interest in the deposited funds in West Virginia for at least nine years (R. 383).

22 "The United States or a State has capacity to take and hold property in trust, but in the absence of a statute otherwise providing, the trust is unenforceable against the United States or a State."

Lankford v. *Platt Iron Works*, 235 U. S. 461, 59 L. Ed. 316.

Farish v. *State Banking Board*, 235 U. S. 498, 59 L. Ed. 330.

Numerous other cases and authorities were cited in support of this contention below, but which, in this brief in opposition, we feel need not now concern this Court.

IV

The principal office of the Debtor was in the Northern District of West Virginia, and the only assets available to constitute "principal assets" of the Debtor within the territorial jurisdiction of the District Court for Southern West Virginia were the funds on deposit with the State of West Virginia. Since by virtue of Point I above (Eleventh Amendment), they were not subject to the jurisdiction of the Court, and since the Debtor did not even retain a residual interest in those funds, then the petition should have been dismissed because of improper venue.

These respondents submit that the term "principal assets" as used in Section 128 of Chapter X means only those assets capable of being taken into possession by the Trustee and susceptible of administration by it.

This is true because of the ancestry of Chapter X, derived from the federal equity receivership rules, as set forth in Finletter "The Law of Bankruptcy Reorganization", page 23. On pages 86 and 91, the author clearly sustains this contention of these respondents, and there being no other assets of the Debtor within the territorial jurisdiction of the District Court, clearly venue was improperly laid.

The District Court only has jurisdiction of the Debtor and "its property wherever located". Sec. 111 of Chapter X. But in West Virginia, Maryland, Iowa and many of the other depository States, legal title to the deposited securities was required to be, by their depository statute, and actually was, transferred to the depository State or proper official thereof. Equitable title, or beneficial interest, was by statute in the contract holders. As shown by the record, at least in the great majority of the depository States, there was not and had not for some years been any actual residual interest for the Debtor. Therefore, the Debtor was at the institution of these proceedings no more the owner of the deposited securities than is the settler of a conventional trust the owner of property transferred in trust by him.

Warner v. *Brady*, 115 F. (2d) 89.

Therefore, the District Court had no jurisdiction over such deposited securities.

V

The State statutes regulating the Debtor and requiring deposits of its securities were enacted under the police power reserved to the States, and if Chapter X of the Bankruptcy Act were construed to grant to a Federal Court the power to enter a decree in conflict with such State statutes, it would violate the Tenth Amendment to the Constituion of the United States.

These State statutes provided in detail for the regulation of the business conducted by companies such as the Debtor, the most important of which was that requiring a deposit of securities to be held in trust for the benefit and protection of the contract holders, such deposit to be made with the State or some official thereof. Congress, under its bankruptcy powers, could not set aside State statutes

on matters of such important public policy without setting at naught the entire theory of State sovereignty; and because the powers of the Federal Government are by the Constitution always subject to the implied limitation that the rights of the Sovereign States reserved by them cannot be transgressed.

Hopkins Federal Savings & Loan Asso. v. *Cleary*, 296 U. S. 315.

Ashton v. *Cameron County District*, 298 U. S. 513.

VI

The delivery of securities by the Debtor under the depository laws of the various States constituted contracts in the public authority within the meaning of Chapter X of the Bankruptcy Act.

Section 116(1) of Chapter X provides that the Judge may permit rejection of executory contracts of the Debtor "*except contracts in public authority.*" These same quoted words are used in Section 216(4).

Respondents contend that these deposits did constitute such contracts made in the public authority, the Debtor having accepted the terms and provisions of these statutes, in order to be permitted to do business in each of the depository States, and that, therefore, the District Judge could not permit them to be rejected.

CONCLUSION

It is respectfully submitted that the petitioners have shown no jurisdiction whereby the petition should be granted, and have shown no reasons, in law or fact, which would justify this Court in granting the petition, and that respondents have set forth many substantial grounds why the petition should be dismissed, and the urgency

therefor, it is respectfully submitted that the petition should be dismissed and the writ of certiorari should not be issued.

Respectfully submitted,

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APPENDIX A

Statutes Considered in this Brief

(Only pertinent parts are quoted)

Federal Statutes

Section 4 of the Bankruptcy Act as amended by the Act of June 25, 1910, 36 Stt. 839, 11 U. S. C. A. 22:

> 22. *Bankrupts; who may become.* (a) Any person, except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this title as a voluntary bankrupt.
>
> (b) Any natural person, except a wage earner or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation, except a municipal, railroad, insurance, or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this title.

Section 141, Chapter X of the Bankruptcy Act (11 U. S. C. A. 541):

> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 144, Chapter X of the Bankruptcy Act (11 U. S. C. A. 544):

> If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Section 146 (3) and (4), Chapter X of the Bankruptcy Act (11 U. S. C. A. 546):

> Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—
>
> • • •
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

Section 150 of Chapter X of the Bankruptcy Act (11 U. S. C. A. 556):

> Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 73 of this title, except that the trustee need not reside or have his office within the district. • • •

Section 158(4), Chapter X of the Bankruptcy Act (11 U. S. C. A, 558):

> A person shall not be deemed disinterested, for the purposes of section 556 and section 557 of this title, if—
>
> • • •
>
> (4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Section 191, Chapter X of the Bankruptcy Act (11 U. S. C. A. 591):

> "• • • No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court."

Section 9(a) of the Investment Company Act of 1940 (15 U. S. C. A, Sec. 80a-9(a)):

> (a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:
>
> • • •
>
> (2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman or employee

of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security;

• • •

(b) Any person who is ineligible, by reason of subsection (a), to serve or act in the capacities enumerated in that subsection, may file with the Commission an application for an exemption from the provisions of that subsection. The Commission shall by order grant such application, either unconditionally or on an appropriate temporary or other conditional basis, if it is established that the prohibitions of subsection (a), as applied to such person, are unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such application.

Section 111, Chapter X of the Bankruptcy Act (11 U. S. C. A. 511):

Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

Sec. 116(1), Chapter X of the Bankruptcy Act (11 U. S. C. A. 516):

Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

• • •

(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate; * * *

Sec. 128, Chapter X of the Bankruptcy Act (11 U. S. C. A. 528):

If no bankruptcy proceeding is pending, an original petition may be filed with the court in whose territorial jurisdiction the corporation has had its principal place of business or its principal assets for the preceding six months or for a longer portion of the preceding six months than in any other jurisdiction.

Section 216(4), Chapter X of the Bankruptcy Act (11 U. S. C. A. 616):

A plan of reorganization under this chapter—

(4) may provide for the rejection of any executory contract except contracts in the public authority; * * *

Constitution of the United States:

Tenth Amendment:

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Eleventh Amendment:

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

West Virginia Statutes

Code of West Virginia (Ch. ____, Art. ____, Sec.____):

31-1-73:

Any stock corporation of this State, except * * * insurance companies, may, by stipulation and grant of particular powers in its charter, authorize any two or more of its stockholders, by agreement in writing to be filed in the office of the corporation, to vest in some person, * * * as voting trustees, the exclusive right to vote the shares of stock of the parties to such agreement, upon all questions * * *."

12-5-2:

Treasurer Custodian of Securities.—The treasurer of this State, unless otherwise expressly provided by law, shall be custodian of all securities belonging to the State of West Virginia or by law required to be deposited with the State or held in legal custody by the State, and all departments of this State, commissioners or agents of the State, who hold any such securities, shall transfer and deliver the same to the state treasurer to be kept and held by him as legal custodian thereof until released in the manner provided by law.

12-5-6:

Whenever, by statute of this State, any public official, board, commission or department of this State is charged with the approval of securities required as collateral for the deposit of public or other funds, or required to be deposited with the state treasurer, or an investment of capital or surplus or a reserve or other fund, is required to be maintained consisting of designated securities deposited with the state treasurer, such securities shall, at the discretion of such public official, board, commission or department, be deemed to include

and mean notes executed by the person or corporation required to make such deposit *and made payable to the state of West Virginia upon demand,* in the event of insolvency or default by such person or corporation, for the benefit of those for whom such securities are deposited, * * *.

33-9-3:

Deposits to Be Made with the Treasurer.—Before a license to transact business in this State shall be issued by the insurance commissioner to any person, association, or corporation within the purview of section one (s. 3446) of this article, the insurance commissioner shall require the applicant to deposit with the state treasurer (in accordance with article five, chapter twelve of this code), in trust, for the benefit of its contract holders, bonds of the state of West Virginia, or such other bonds, and securities including bonds issued by the West Virginia bridge commission as may be approved by said insurance commissioner, or both, to the aggregate amount of one hundred thousand dollars, and, in addition to such deposit, such person, association or corporation shall maintain at all times a deposit with the state treasurer of bonds and securities approved by the insurance commissioner to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit: Provided, That when, by the laws of any other state, any such person, association or corporation shall have been required to make and shall have made such deposit in such state, equal or greater in amount for the benefit of contract holders in such state, upon the filing of a certificate to such effect from the proper officer in such state with the insurance commissioner of this State, such person, association or corporation shall not be required to

make such deposit with the treasurer of this State for the benefit of its contract holders in such other state; and when the laws of any other state require such deposit less in amount, such person, association or corporation shall file a certificate from the proper officer in such state with the insurance commissioner of this State showing the amount of the deposit made, and shall deposit with the treasurer of this State an amount which, together with the deposit made in such other state, shall make up the total amount required by this State to be deposited by such person, association or corporation, and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount.

33-9-10:

Authority of Insurance Commissioner; Control of Deposit Where License Revoked.—The insurance commissioner shall have the same authority over every person, association, or corporation engaged in selling annuity contracts, certificates, or bonds, as over insurance companies, and if in his opinion the assets are impaired or such person, association or corporation is not complying with the law, said commissioner shall have authority to revoke the license of such person, association, or corporation to do business in this State, and, if such license is so revoked, the deposit or a sufficient amount of same, shall remain under the authority and control of the insurance commissioner until the total liability of all the contracts, certificates or annuity bonds or contracts issued by such person, association or corporation in this State is redeemed or settled.

33-2-45:

Proceedings in Circuit Court of Kanawha County against Insolvent Company.—Whenever any company under the supervision and regulation of the insurance commissioner shall become insolvent or shall be in such financial condition as not to be able to pay its creditors in this State, the commissioner of insurance may file a bill in the circuit court of Kanawha county for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in this State and the distribution of its assets among those entitled thereto according to their respective right.

33-2-12:

Time Licenses Shall Continue in Force.—All licenses, or certificates of authority issued by the insurance commissioner to insurance companies or associations, or agents, solicitors or brokers, shall continue in force until the first day of April next following their issuance unless the same be sooner revoked.

Article VI, Section 35, Constitution of West Virginia:

The State of West Virginia shall never be made defendant in any court of law or equity, except the state of West Virginia, including any subdivision thereof, or any municipality therein, or any officer, agent, or employee thereof, may be made defendant in any garnishment or attachment proceeding, as garnishee or suggestee.